

**THE COMMONWEALTH OF MASSACHUSETTS
BEFORE THE DEPARTMENT
OF TELECOMMUNICATIONS AND ENERGY**

BAY STATE GAS COMPANY

D.T.E. 01-81

**SUPPLEMENTAL TESTIMONY OF TIMOTHY NEWHARD
ON BEHALF OF
THE ATTORNEY GENERAL**

June 7, 2002

**Bay State Gas Company
D.T.E. 01-81
Testimony of Timothy Newhard
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I. INTRODUCTION

Q: Please state your name and business address.

A: My name is Timothy Newhard. My business address is Office of the Attorney General,
Public Protection Bureau, Utilities Division, 200 Portland Street, Boston, Massachusetts
02114.

Q: Are you the same Timothy Newhard that prefiled testimony on behalf of the Attorney
General in this case ?

A: Yes, I am.

Q: Please describe the purpose of your Supplemental Testimony in this case.

A: The purpose of my Supplemental Testimony in this case is to respond to issues raised by
the Supplemental Prefiled Direct Testimony of Bay State Gas Company's (the
"Company") witness Stephen H. Bryant in this case.

Q: Please summarize Mr. Bryant's Supplemental Prefiled Testimony.

A: Mr. Bryant's Supplemental Prefiled Testimony changes the Company's original proposal
for its Gas Cost Incentive Mechanism ("GCIM"). Among other changes, the Company

**Bay State Gas Company
D.T.E. 01-81
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1 now proposes to eliminate the pass through of trading losses to customers as a result of
2 the Company's activities through the GCIM, while leaving the Company the option at
3 some future time to revert to the original proposal which allows the pass through of
4 trading losses.

5
6 Q: Please summarize your Supplemental Testimony and recommendations.

7 A: The proposed changes to the Company's original GCIM that are put forth by Mr. Bryant
8 in some ways mitigate the losses that customers will incur as a result of the GCIM.
9 However, at the same time, the Company's change to its GCIM will increase its cost of
10 capital, thus reducing and perhaps eliminating any potential benefit from the GCIM. This
11 could have a potentially devastating impact on the Company's financial position.
12 Ultimately, Mr. Bryant's claim that customers will not be burdened with any losses as a
13 result of the revised proposal is simply wrong.

14
15 Q: Please explain why the Company's proposal to eliminate trading losses from the GCIM
16 will not eliminate losses for customers.

17 A: The Company's proposal to eliminate trading losses from the GCIM will not eliminate
18 losses for customers, because the Company has not considered all of the costs of GCIM.
19 As I indicated in my prefiled testimony in this case, the incremental costs of the GCIM

**Bay State Gas Company
D.T.E. 01-81
Testimony of Timothy Newhard
June 7, 2002**

1 include the following:

- 2
- 3 - an increased cost of capital as the utility puts its assets and earnings at greater risk
4 due to the general potential for losses associated with the GCIM proposal itself as
5 well as the specific risks associated with the new venture into speculating in the
6 derivative securities markets;
7
 - 8 - the new transaction costs associated with the firm performing the actual trading of
9 the derivative securities on the boards;
10
 - 11 - the new company employees and consultants to manage, facilitate, and carry out
12 trading activities;
13
 - 14 - the new computers, and computer software to support the trading activities;
15
 - 16 - the new accounting and auditing costs;
17
 - 18 - the added insurance costs associated with the traders of and the trading in the
19 financial derivatives;
20
 - 21 - the new Department employees to analyze and oversee the prudence of this new
22 activity; and,
23
 - 24 - the other regulatory costs associated with the regulatory proceedings including
25 legal fees, transcript costs, copying costs, expert witnesses, and filing fees.
26

27 Since the Company's new proposal only eliminates the trading losses, customers will still
28 be burdened with all of these other incremental costs which could cost millions of dollars.

Bay State Gas Company
D.T.E. 01-81
Testimony of Timothy Newhard
June 7, 2002

1 Q: Please explain your statement that the Company's cost of capital will increase as a result
2 of the revision of the GCIM.

3 A: The revision to the GCIM will cause the Company's cost of capital to increase because it
4 will not have the benefit of passing off some of the trading losses to customers. Investors
5 will see this new incremental risk and adjust their cost of capital accordingly. Ultimately,
6 this means that customers will pay for this increased cost of capital, thus raising overall
7 rates to customers from what they would have been otherwise. Again, the Company has
8 not considered these costs in any of its analyses.

9
10 Q: You indicated that an increase in the Company's cost of capital could have devastating
11 consequences for the financial integrity of the Company, is that correct ?

12 A: Yes. I did.

13
14 Q: Please explain that statement.

15 A: Bay State Gas Company has one of the lowest rated bonds of any regulated utility in
16 Massachusetts. In fact, the bond ratings agencies put the Company at their lowest
17 investment grade rating. Standard & Poors rates the Company BBB- and Moodys rates
18 the Company Baa3. In both cases, the Company is on the edge of being non-investment
19 grade. If this occurs, many institutions will not be able to trade in their securities. If the

Bay State Gas Company
D.T.E. 01-81
Testimony of Timothy Newhard
June 7, 2002

1 Company's bond rate is lowered to non-investment grade, this will increase the cost of
2 trading in the commodities market and financial derivatives market. More importantly,
3 however, it will dramatically increase the cost of capital for the Company for the debt and
4 equity that it issues. If the Company loses its investment grade rating, this will almost
5 certainly eliminate any hope of benefits that the Company alleges it will pass on to
6 customers. Therefore, not only is the GCIM an inappropriate burden on the Company's
7 customers, since in all likelihood customers will bear a net cost as its result, but it is also
8 inappropriate for this particular Company, given its current bond rating. Any increase in
9 that risk could have devastating results. For these reasons and those described in my
10 prefiled testimony, the Department should reject Bay State Gas Company's GCIM
11 proposal in its original as well as its revised forms.

12
13 Q: Does that conclude your Supplemental Testimony.

14 A: Yes. It does.